

**Office of Chief Counsel
Internal Revenue Service
memorandum**

CC:LM:RFP:JAX:NAS:TL-N-846-01
VCBrooks ID# (b)(7)c :BAD

date: June 1, 2001

to: Taxpayer Advocate Problem Resolution Unit
5880 Nolensville Road, MDP 112
Nashville, Tennessee 37211

from: Associate Area Counsel (LMSB) Area 3 - Nashville

Subject: [REDACTED] (Formerly [REDACTED])
[REDACTED]
EIN: [REDACTED]
Short Year Ending [REDACTED]

This is in reply to the memorandum from Dennis Robinson (TAO) of your office requesting our opinion on the issue stated below.

ISSUE

Whether interest with respect to the tax reported on the taxpayer's return for the short year ending [REDACTED], was correctly assessed by the Service Center for the period beginning [REDACTED], until [REDACTED], when the taxpayer filed the return (and paid the tax) and also filed a consolidated return with its common parent for the year ending December 31, [REDACTED].

CONCLUSION

The interest on the tax reported on the return was not owed for the period assessed because under the regulations discussed below the return was not due until [REDACTED], when the tax was paid. The interest therefore should be abated in the same manner that the Service Center has abated the failure to file penalty, the failure to pay penalty and the estimated tax penalty.

FACTS

According to a letter from the taxpayer's representative, [REDACTED] of [REDACTED], the taxpayer received a notice from the Internal Revenue Service Center in Kansas City

stating that because the taxpayer's tax return for the short year ending [REDACTED], was filed late and the tax liability was not paid by the due date, a failure to file penalty, a failure to pay penalty, and an underpayment of estimated tax penalty was assessed. The letter proceeded to explain that the filing and paying of the tax liability by [REDACTED], was not late based on the facts set forth below.

On [REDACTED], [REDACTED] ([REDACTED]) purchased [REDACTED] % of the stock of the taxpayer, [REDACTED] ([REDACTED]). As a result, [REDACTED] was included in a consolidated return with [REDACTED] as the common parent for the year ending December 31, [REDACTED], which return was filed pursuant to Treas. Reg. § 1.1502-76(a) on the basis of [REDACTED]'s taxable year. Since [REDACTED] and [REDACTED] are both calendar year taxpayers no change in accounting period was required. The income of [REDACTED] for the portion of the consolidated return year during which it was a member of the group was included in the consolidated return pursuant to Treas. Reg. § 1.1502-76(b)(1). The income earned by [REDACTED] prior to the affiliation was included in a separate return on Form 1120 filed for the period [REDACTED], through [REDACTED]. The portion of [REDACTED] income includible in each of the two returns was determined on the basis of it's income shown on it's permanent records for the periods involved. Both returns were filed on [REDACTED].

Based on the above facts, the taxpayer contends that under Treas. Reg. § 1.1502-76(c) the due date for filing the return for the short period of [REDACTED] was the due date of the consolidated return. Thus, the due date of the return for [REDACTED], in the absence of an extension, for the separate return was [REDACTED], based on its former calendar tax year and based on the due date of the consolidated tax return for [REDACTED].

In addition, the taxpayer contends that under Treas. Reg. § 1.6655-5(b)(1), if a corporation's taxable year is less than four months, no payment of estimated tax is required. Since [REDACTED]'s separate return was for the three month period [REDACTED], through [REDACTED], the taxpayer states that no estimated tax payments were made. As a result, the representative's letter requested that the Service Center waive all penalties and interest assessed on the tax notice dated [REDACTED].

Apparently, as a result of such letter the Service Center, according to transcripts supplied to us dated [REDACTED],

has abated the failure to file penalty in the amount of \$ [REDACTED], the estimated tax penalty in the amount of \$ [REDACTED] plus a failure to pay penalty in the amount of \$ [REDACTED]. However, it has not abated interest of more than \$ [REDACTED] which apparently represents interest from [REDACTED], when the short return would normally have been due until the tax payment of \$ [REDACTED] was made on or about [REDACTED].

According to Mr. Robinson, your office in response to prior requests for abatement of penalties and interest with respect to returns filed for short periods prior to a merger and the filing of a consolidated return (such as in the instant case), have honored the taxpayer's request for abatement of both the penalties and interest. But in such cases, the interest assessed was a nominal amount and did not rise to the more than \$30,000 such as in the instant case. Because of the amount involved here plus the fact that there seems to be an increase in the filing of short returns due to mergers by corporate taxpayers, Mr. Robinson believed the question warranted our legal opinion before abatement of the interest as requested by the taxpayer.

ANALYSIS

At first blush, we agree with Mr. Robinson that it would appear that the taxpayer would be receiving a windfall if it was not required to pay any estimated tax or interest on the tax due for the short period ending [REDACTED] until [REDACTED]. Nevertheless, it would appear that based on the pertinent statutes and regulations that the taxpayer would not have been required to pay the tax due on the short return until the date the consolidated return was due to be filed on [REDACTED], and therefore there was no late payment of the tax upon which interest would be due.

Under Section 6601 of the Internal Revenue Code interest is due on any amount of tax required to be shown on a return if not paid on or before the last date prescribed for payment, at the rate established under I.R.C. § 6621, from such last date to the date paid. Generally speaking, the last date prescribed for payment for tax required to be shown on a return is deemed to be the due date (without regard to extensions) of the return for the taxable year. See I.R.C. § 6151(a). Under Treas. Reg. § 1.6072-2 the time for filing a corporate return under I.R.C. § 6012 is the fifteenth day of the third month following the close of the taxable year. Thus, the due date for the filing of the

taxpayer's return for the short period ending [REDACTED], would be [REDACTED]. However, under Treas. Reg. § 1.1502-76(c) the time for filing a separate return for the period not included in a consolidated return would appear to be the due date of the consolidated return. This regulation is quoted below:

(c) Time for making separate returns for periods not included in consolidated return-(1) Consolidated return filed by due date for separate return. If the group has filed a consolidated return on or before the due date for the filing of a subsidiary's separate return (including extensions of time and determined without regard to any change of its taxable year required under paragraph (a) of this section), then the separate return of any portion of the subsidiary's taxable year for which its income is not included in the consolidated return of the group must be filed no later than the due date of such consolidated return (including extensions of time).

As noted above, the taxpayer relies on the quoted regulation to excuse the failure to file and failure to pay penalties assessed by the Service Center when its return for the short period was not filed until [REDACTED]. The taxpayer's position would appear to be correct and in accord with Example (2) of Treas. Reg. § 1.1502-76(c)(3). Although the quoted regulation does not specifically refer to a return for a short period and the meaning thereof seems somewhat circuitous, it is clear that the regulation intended to prescribe the time for filing returns for a short period, based on a reading of the sections in the prior paragraphs of the cited regulations. See Treas. Reg. § 1.1501-76(b) (1)(ii), (b)(2)(i) and (b)(4). The policy behind the regulation is to allow the taxpayer to wait until the end of the year to decide whether it will file a separate return for its taxable year or join in the consolidated return with its new parent as illustrated in some detail in Treas. Reg. § 1.1502-76(c) and the examples therein.

In granting the taxpayer a grace period in which to make such decision the regulation apparently did not consider the possibility that the taxpayer would not be required to pay interest or estimated tax for the tax reported on the return for

the short period under the facts involved here.¹

Under I.R.C. § 6655, large corporations are required to pay 100% of the current year's tax in four installments on April 15, June 15, September 15, and December 15. There is an estimated tax penalty for any underpayment of the estimated tax by the corporation which is based on the underpayment rate prescribed by I.R.C. § 6621 for the period of the underpayment as set forth in Section 6655(b). Thus, ordinarily if the taxpayer had filed its return for the calendar year [REDACTED], it would have owed one fourth of the tax to be paid as an installment by April 15, [REDACTED]. However, proposed Treas. Reg. § 1.6655-5(b)(1) provides for an exception to the payment of estimated tax in the case of a short taxable year. If the period is less than four months, no payment of estimated tax is required under Section 6655. The taxpayer relies upon this proposed regulation to request that the estimated tax penalty be abated.

Again the regulation supports the taxpayer's position, and obviously is the authority relied upon by the Service Center to abate the estimated tax penalty. Indeed, we have ascertained that the position has been retained in the new proposed regulations under Section 6655 presently being reviewed in the National Office.

Accordingly, based on the above analysis, we believe that any interest assessed with respect to the tax reported by the taxpayer on the return for the short period filed on [REDACTED], when the return was due, should be abated in the same manner as the failure to file penalty, the failure to pay penalty and the estimated tax penalty have been abated.

Since our conclusion may be a significant one that warrants a review of the procedure regarding the assessment of interest with respect to a return for a short period by the Service Center, we are forwarding our opinion to our National Office for post review.

¹Nor did the regulation seem to deal with the possibility that there may be a manipulation of income between the two returns by the taxpayer to take advantage of the late payment of tax permitted on the short return. If such manipulation occurred, however, it would appear to be subject to an adjustment on a subsequent audit which would result in additional interest and an estimated tax penalty on the consolidated return; i.e., if detected.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, including the attorney/client privilege. If disclosure becomes necessary, please contact this office for our views.

We hope to advise you of the National Office's reply within 20 days. In the meantime, if you have any questions, do not hesitate to telephone the undersigned any time at (615) 250-5509.

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